

Smart ideas about wealth

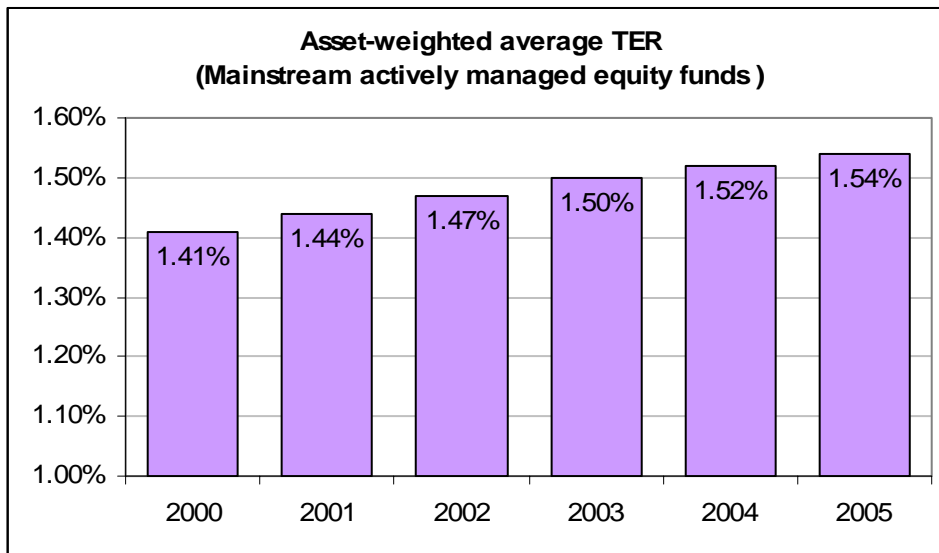
When less is more

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In most sectors, when the price of a good or service rises, demand usually falls. However, higher priced goods and services usually offer better quality or superior benefits than their lower priced alternatives and more affluent consumers are happy to pay a premium for the real or perceived benefits. Otherwise why would people buy an Aston Martin when a Nissan Micra is able to get them around equally as well?

Investment management seems to be the only business where demand increases as prices rise, even though there is no discernible benefit for paying more. While future performance is not certain, charges are and there is no point in paying more than is necessary, particularly as returns in the future are highly likely to be lower than we have seen over the past 30 years.

Research from Fitzrovia*, indicates that the overall annual management costs levied by UK retail investment funds, known as total expense ratios (TERs), have risen, even though the value of assets being managed has risen considerably. The asset-weighted average TER of mainstream actively managed equity funds in 2005 had increased to 1.54% per annum from the previous year's 1.52%. As the chart shows, something of a clear trend is becoming apparent and it's not one that is obviously beneficial to investors.



However, the total expense ratio, despite its name, is not the whole story when it comes to assessing fund costs. In more recent research by Fitzrovia**, they found that the median turnover (the amount of buying and selling carried out by the manager) for actively managed equity funds was 58% in a year. Portfolio turnover is important because as several academic studies have calculated, it has an impact on investors' net returns – estimates vary between 0.95% to 1.3%pa per 100% of turnover. Thus the impact of turnover on the median actively managed equity fund might be expected to be between 0.55% and 0.75%pa.

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If one adds the TER to the implicit transaction costs, we are looking at over 2% annum total costs – that is without even considering the cost of advice or ongoing service. If we were to look at hedge funds, then the costs would be much, much higher, as management fees alone of 2%pa are not uncommon with performance fees and substantial turnover costs in addition. Actively managed funds and portfolios cost a lot and there is no evidence that this extra cost results in higher risk-adjusted returns to investors.

At Bloomsbury we are always looking to drive down costs and improve our service. The two are not mutually exclusive and it is possible to provide better service, solutions and communication while at the same time reduce costs. The aggregate cost of our comprehensive financial planning service, investment management, custody, and funds is considerably below the costs identified in the Fitzrovia research.

So the conclusion is clear. Individuals who are delegators, with better things to do with their time than spend hours each week managing their wealth, should find a good adviser who can deliver a comprehensive, professional and personalised service and construct and regularly rebalance a low cost index portfolio. Not only will they pay a lot less than the 'average' investor but they are highly likely to have a better investment experience!

If you have at least £1m of liquid assets and you'd like us to give you a second opinion on your overall position, including a review of your portfolio, do get in touch with us. Chances are you're paying well over the odds for mediocrity.


* Lipper Fitzrovia – 'Trend Analysis of UK Funds' Fees and Expenses January 2006

** Lipper Fitzrovia – 'Benchmarking UK Portfolio Turnover' December 2006

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